Supreme Court of the United States

OCTOBER TERM, 1944.

No. 137

PRUDENCE REALIZATION CORPORATION,
Petitioner,

—against—

JOSEPH W. FERRIS, GEORGE L. LONG and HENRY LEIFERT as Trustees under a Declaration of Trust dated as of July 1st, 1938, with respect to 307 West 36th Street (Burnside) First Mortgage Participation Certificates, CITY BANK FARMERS TRUST COMPANY and MARTIN S. LINDGROVE as Trustees under the Last Will and Testament of HERMAN STUTZER, deceased, on behalf of themselves and other holders of certificates in 307 West 36th Street (Burnside) First Mortgage Participation Certificates, SOLOMON ZAUDERER, MILTON KIMMELMAN, IRVING ZAUDERER and CHARLES KIMMELMAN, doing business as KIMMELMAN AND ZAUDERER, on behalf of themselves and all other holders of Prudence Bonds Corporation participating certificate issue, and HUNTER L. DELATOUR, RAYMOND REISLER and JEROME THRALLS, Trustees of Realty Associates Securities Corporation, Debtor, holders of Burnside Certificates,
Respondents.

BRIEF FOR RESPONDENTS JOSEPH W. FERRIS, HENRY LEIFERT AND GEORGE L. LONG AS TRUSTEES UNDER A DECLARATION OF TRUST DATED AS OF JULY 1, 1938.

CHARLES H. KRIGER,
Counsel for Respondents
Joseph W. Ferris, etc.

HENRIETTA KRIGER,
Of Counsel.

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Respondents.

BRIEF FOR RESPONDENTS JOSEPH W. FERRIS, HENRY LEIFERT AND GEORGE L. LONG AS TRUSTEES UNDER A DECLARATION OF TRUST DATED AS OF JULY 1, 1938.

THE OPINIONS OF THE COURT BELOW.

The opinion in the Supreme Court is unreported (R. 221).

The opinion in the Appellate Division is reported at 266 App. Div. 543 (R. 231).

The opinion in the Court of Appeals is reported at 292 N. Y. 210 (R. 241).

STATEMENT.

Actions No. 1 and No. 2 were brought for the same relief. Action No. 1 was brought by Joseph W. Ferris, George L. Long and Henry Leifert as Trustees under a Declaration of Trust for first mortgage participation certificates known as the Burnside Issue. They are respondents in this court and will be hereinafter referred to as Trustees-respondents. The action was for a declaratory judgment declaring the rights and interests of Prudence Realization Corporation, hereinafter referred to as the petitioner, and of other certificate holders in the bond and mortgage for which the Trustees-respondents are trustees. Action No. 2 was brought by a certificate holder for the same relief. The two actions were consolidated in the New York Supreme Court and proceeded as one action.

Trustees-respondents were appointed as trustees under a plan of reorganization of the Burnside mortgage issue promulgated and confirmed in the United States District Court for the Eastern District of New York. The plan under which they were appointed dealt only with the Burnside issue, although it was promulgated as part of a proceeding then pending to reorganize Amalgamated Properties, Inc., hereinafter referred to as Amalgamated, under Section 77 B of the bankruptcy law (R. 89).

Amalgamated was the owner in fee of the premises covered by the mortgage. It was in no wise liable to the certificate holders, not having made the bond nor entered into any engagement to pay either principal or interest. Amalgamated was a subsidiary of The Prudence Company, Inc., herein-

after referred to as Prudence, and it acquired title in June, 1932 after the prior owner had defaulted on the mortgage (R. 14).

The petitioner is a successor in interest to Prudence by reason of the reorganization of Prudence under Section 77-B of the Bankruptcy Act. Prudence was the guarantor of the principal and interest of the mortgage certificates (R. 12). In February, 1935, a petition for reorganization was filed on behalf of Prudence under Section 77-B of the Bankruptcy Act (R. 14). Originally, the proceeding to reorganize Amalgamated was part of the Prudence proceeding, but in April, 1938, an order was entered severing the two proceedings and thereafter, the Prudence proceeding and the Amalgamated proceeding continued as separate and distinct proceedings (R. 89).

Amalgamated, in addition to owning the Burnside property was also the owner of various other properties acquired by it in substantially the same way that it acquired the Burnside property. The plan for the Burnside issue did not involve any other property of Amalgamated. Other plans for other certificate issues, not material here, were promulgated as separate and distinct plans of reorganization. Each issue was treated as a separate and distinct proceeding just as if each property were owned by a separate and distinct corporation, each with its own creditors (R. 125).

The bond and mortgage were originally in the sum of $1,260,000 (R. 172). The bond and mortgage by their terms became due July 1, 1932 (R. 89), and all certificates matured on that day (R. 90). Certificates were originally issued to the full extent of the mortgage but certificates totaling $84,000 were retired by amortization payment of the former owner (R. 90). Most of the certificates acquired by Prudence were acquired after July 1, 1932 and a few were acquired during the month of June, 1932 as shown by Defendant's Exhibit "D" (R. 40).

The previous owner of the premises had defaulted in an installment of principal due January, 1932 and Prudence caused the property to be acquired by Amalgamated in June, 1932 (R. 90).

The Burnside plan provides for the execution of a declaration of trust by the Trustees-respondents (R. 98); for the transfer of title to the mortgage and title to the real estate to the Trustees-respondents (R. 97). It declares that the Trustees-respondents shall be the legal owners in trust for the benefit of certificate holders (R. 118). It assigns to the trustees all rights which the certificate holders had as a class (R. 106). It provides that the Trustees alone may enforce the bond and mortgage and that the rights of the certificate holders shall be those of the beneficiaries of a trust (R. 102), for income interest to certificate holders up to 2½% per annum (R. 100), and for the filing of annual accounts by the Trustees-respondents in the Supreme Court of the State of New York (R. 98). It provides for retirement of certificates through operation of a sinking fund (R. 101). It provides for payment to Amalgamated of $1,000 out of moneys obtained from operation of premises as consideration for the deed (R. 122). As originally promulgated, it provided that all certificates were on a parity. This provision however, was amended (R. 120) by striking out the paragraph providing for parity and substituting an entirely new provision (R. 120). This new provision is set forth at length in the Record (R. 120, 121, 122). Part of it is quoted in petitioner's brief, but part only.

The first sentence of the new provision states that except as provided in the provision, all certificates shall be entitled to participate on a parity, but excludes Prudence from the first operation of the sinking fund. The second sentence states that a question has arisen with respect to the rights of Prudence. The third sentence states that no distribution shall be made to Prudence until a final adjudication by a court of competent jurisdiction on the issue. There follows a provision declaring that distribution shall be made in accordance with an adjudication and a further provision directing the Trustees-respondents to hold monies in escrow, which Prudence would be entitled to if it were on a parity. Next follows a modification of the provisions for distribution in accordance with the final adjudication by the provision

that publicly held certificate holders would receive only half of the interest allocated to the Prudence certificates up to 5% per annum, and the balance would be placed in a sinking fund. Finally, the provision prevents the retirement of Prudence certificates by the sinking fund unless parity is adjudicated.

The Petitioner has stated upon several occasions in its brief, that this provision was inserted solely to avoid delay in consummating the 77-B plan for the certificate issue. There is nothing in the record of the proceedings held in the bankruptcy court which justifies such a statement and petitioner cannot point out anything but its own unsupported statement to that effect. We believe that it was the intention of the parties to leave the issue of parity unaffected by the plan and hence there was no reason for an adjudication of the issue in the bankruptcy court, and we shall develop that point further under our argument. In any event, we submit that the effect of this provision of the plan is to be determined by an analysis of the meaning of its provisions. In such an analysis, we submit that the reasons assigned by the petitioner play no part.

The complaint contains two causes of action. The first seeks an adjudication of the relative rights of the parties on the question of parity; the second, an accounting of money received by Prudence upon its certificates as interest and to which other certificate holders would be entitled in the event Prudence certificates are subordinate.

The New York Court of Appeals in an opinion by Judge Thacher, unanimously held that the certificates held by the petitioner are subordinate to those held by others in an opinion printed on page 241 of the record, and reported at 292 N. Y. 210. It decided:

FIRST: That the Burnside Plan of Reorganization did not define or determine the rights of the parties with respect to parity, nor were such rights determined by the Bankruptcy Court in the course of its administration or in connection with the distribution of any of the assets of either Prudence or Amalgamated;

SECOND: That where neither a Plan of Reorganization nor any order in the proceedings undertakes to modify the legal rights of the parties, that such rights remain as they were before the institution of the bankruptcy proceeding;

THIRD: The under the New York Law the certificates held by Prudence are subordinate to those publicly held.

We quote from the opinion of the Court of Appeals as follows, page 245 of the Record (*Ferris* v. *Prudence Realization Corp.*, 292 N. Y. 210, at page 218):

> "Upon this record it appears without contradiction that the Burnside plan of reorganization did not attempt to define or determine the relative rights of Realization Corporation as the holder of certificates acquired by Prudence and of other holders of Burnside certificates, nor was any determination of these rights made in the Bankruptcy Court in the course of its administration or in connection with the distribution of any of the assets either of Prudence or of Amalgamated. The controversy, therefore, was brought to the State courts, as contemplated by the plan of reorganization for determination of these relative rights unaffected by the reorganization consummated in the Federal court.
>
> "Corporate reorganization in the Federal courts is a process of adjustment and modification of legal rights frequently involving the impairment of contractual obligations under plans predicated upon the consent of security holders and creditors and upon the court's approval of the plan as fair and equitable and therefore binding upon the minority. If neither the plan nor any order in the proceeding undertakes to modify the legal rights but leaves those rights to be determined by courts of competent jurisdiction, such courts have no power to impair the legal or equitable rights of the parties. The court below erroneously regarded the *Geist* case as establishing a rule. It was only effective in determining a question affecting the administration and distribution of assets in the particular reorganization before the court. To conclude

that our decision is ruled by the decision of the Supreme Court in the *Geist* case, we should have to modify the Burnside plan of reorganization, which did not undertake to determine, define or modify the relative rights of certificate holders under the Burnside mortgage."

SUMMARY OF ARGUMENT.

POINT I. Prior To The Institution Of The Bankruptcy Proceeding New York Law Subordinated Certificates Held By Petitioner.

POINT II. Priority Rights Acquired Under State Law Are Not Affected By A Reorganization Proceeding In Which Such Rights Are Not Defined, Determined Or Modified.

POINT III. The Bankruptcy Proceedings Did Not Accord Petitioner Parity.

POINT IV. The Rule In Prudence Realization Corp. v. Geist, 316 U. S. 89, Does Not Apply To This Case.

POINT V. The Burnside Plan Cannot Be Modified Or Amended In This Action. The Plan Is Not Subject To Collateral Attack.

POINT VI. The Judgment Is Right And Should Be Affirmed.

POINT I.

PRIOR TO THE INSTITUTION OF THE BANKRUPTCY PROCEEDING NEW YORK LAW SUBORDINATED CERTIFICATES HELD BY PETITIONER.

The State of New York is the place where the land is situated and where the bond and mortgage, the participation certificates, the agreement of guarantee and the deposit agreement were made and delivered. Prior to the institution of any proceeding in bankruptcy, any litigation involving the rights of any parties in and to any of these instruments, would be determined according to the law of the State of New York. This would be true whether the action was in the New York Court or in the federal court, and whether the action was one at law or in equity.

Erie R. Co. v. *Tompkins*, 304 U. S. 64;
Ruhlin v. *N. Y. Life Ins. Co.*, 304 U. S. 202;
Huddleston v. *Dwyer*, 322 U. S. 232;
Meredith v. *Winter Haven*, 320 U. S. 228.

The decision under such circumstances, would involve no federal question and would not be the subject of review by this court.

Sauer v. *City of New York*, 206 U. S. 536;
Murdock v. *City of Memphis*, 20 Wall 590;
Central Hanover Bank v. *Kelly*, 319 U. S. 94.

We respectfully submit that had the issue of parity been submitted for determination prior to the institution of the bankruptcy proceedings, that under the well-settled doctrine of the New York Court, the certificates held by the general public would have been declared to be superior to those held by Prudence.

Ferris v. *Prudence Realization Corp.*, *supra*, (292 N. Y. 210).

POINT II.

PRIORITY RIGHTS ACQUIRED UNDER STATE LAW ARE NOT AFFECTED BY A REORGANIZATION PROCEEDING IN WHICH SUCH RIGHTS ARE NOT DEFINED, DETERMINED OR MODIFIED.

We respectfully submit that unless proceedings held in the bankruptcy court deprived the publicly held certificates of this superiority, that such certificate holders are still entitled to priority. The question before this Court, is the narrow one: Did the bankruptcy proceedings accord Prudence parity? Admittedly, prior to the institution of the bankruptcy proceeding, Prudence did not have parity. If it did not get parity in the bankruptcy proceedings, it cannot claim parity in this action. If indeed, the proceedings in the bankruptcy court accorded Prudence parity, then of course, Prudence would be justified in claiming that a "right, privilege or immunity" granted under a statute of the United States, is denied it by the decision below. The sole federal question which can be raised before this court must be based upon such "right, privilege or immunity." If on the other hand, the bankruptcy proceeding did not accord Prudence parity, then it cannot be claimed that the Court of Appeals denied any such federal right.

We shall devote ourselves to the question of whether or not the bankruptcy proceedings accorded Prudence parity. We have used the term "bankruptcy proceedings" loosely, intending thereby to encompass the provisions of the bankruptcy law, orders made during the course of the bankruptcy proceeding, and the plan of reorganization confirmed by the court.

We do not understand that the petitioner claims that the mere filing of the petition in bankruptcy washes away rights of priority theretofore existing. No such claim could reasonably be made. The filing of a petition in bankruptcy does not of itself, alter the existing rights of parties. Property in the hands of the bankruptcy court is subject to all

of the equities to which it was subject in the hands of the bankrupt.

Hewit v. *Berlin Machine Works*, 194 U. S. 296;
Security Warehousing Co. v. *Hand*, 206 U. S. 415.

In the case of *Security Warehousing Co.*, v. *Hand*, this Court said at page 423:

> "It is no new doctrine that the assignee or trustee in bankruptcy stands in the shoes of the bankrupt, and that the property in his hands, unless otherwise provided in the bankruptcy act, is subject to all of the equities impressed upon it in the hands of the bankrupt."

In an ordinary bankruptcy, the adjudication discharges no liability of the bankrupt. It is the discharge and not the adjudication which frees the bankrupt from debt. Of course, during the bankruptcy proceeding, there is a suspension of the rights of the creditor to enforce collection of the debt. The bankruptcy court takes full possession of all assets of the bankrupt and administers it. The institution of bankruptcy proceedings does not automatically stay proceedings in other courts, although the bankruptcy court can and does enjoin state court proceedings. The jurisdiction of the bankruptcy court to administer the property of the bankrupt, is exclusive. In an ordinary bankruptcy case, if no discharge is granted, a creditor may pursue the adjudicated bankrupt and enforce satisfaction. When discharged, the bankrupt is cleared of his debt. Reorganization proceedings under Section 77 B of the Bankruptcy Act are bankruptcy proceedings. They are a substitute for reorganizations under equity receivership.

Securities Exchange Commission v. *United States R. & Imp. Co.*, 310 U. S. 434.

Within the framework of the statute, a corporation is permitted to modify or alter the rights of creditors and of stock

holders. The manner and degree in which such rights are modified or altered is to be embodied in a writing, is to be accepted by the requisite number of creditors affected by the plan. The consent of the stockholders is not required if the debtor is insolvent or their rights are not effected by the plan. Upon confirmation of the plan, it is binding upon all persons. It is the plan when approved and confirmed which determines the rights of creditors and stockholders. By the necessities of the case, all plans are not alike. The two plans of reorganization printed in the record namely, the Burnside plan and the Prudence plan, are different. They are different because the problems involved in each reorganization are different. In this case, there is no contention made that any order in the proceeding accorded Prudence parity. Nor is there a claim that any statute has that effect. No provision of the Bankruptcy Act has been pointed out and none can be pointed out which automatically accords Prudence parity. We must therefore look to the plan for determination of this question.

POINT III.

THE BANKRUPTCY PROCEEDINGS DID NOT ACCORD PETITIONER PARITY.

The petitioner in its argument has tried to make it appear that the Court of Appeals overlooked or disregarded modifications of the rights of certificate holders and hence fell into error, but this argument overlooks the issue before the Court of Appeals. That issue was whether or not Prudence certificates were on a parity or subordinate. That was the only issue involved in the case, and the issue to which the Court directed its attention in its opinion. The question for its determination was whether in the bankruptcy proceeding, the Prudence certificates which otherwise would be subordinate had been accorded parity and the determination of the Court was that neither the plan nor any order in the bankruptcy proceeding accorded such parity.

modify the rights of the parties, it would have been simple to say so in definite language. If the question was whether or not such a state law priority was to be recognized by the bankruptcy court, that too, could have been explicitly stated. Even if there were a desire for haste in consummating the plan, the bankruptcy court could have retained exclusive jurisdiction to determine the question either before or after consummation of the plan. In 1938, when this plan was approved by the certificate holders and the Court, all were fully aware of the many state court proceedings then pending and undetermined in which similar issues of parity as between certificate holders and guarantors were involved. *Prudence Realization Corporation* v. *Geist*, 316 U. S. 89, had not yet been decided. The parties unquestionably were thinking in terms of state law. The Judge, who confirmed the Burnside plan, was likewise thinking in terms of the rights of the parties under the state law. We say this because he was the same Judge who was in charge of the reorganization involved in the *Geist* case, and in his opinion in that case, he determined the question solely upon consideration of the pertinent state court decisions. The reversal of his decision in that case by this court does not change the fact that he thought that the question of parity was determinable according to state law. We cannot bring ourselves to seriously consider petitioner's suggestion that the reservation of the question meant that the question was to be determined by any court in accordance with the rules of distribution prevailing in bankruptcy. Bankruptcy courts often consent that the interest of parties in property ~~without~~ within the jurisdiction of the bankruptcy court, be adjudicated by a state court, either because of convenience or what is thought to be unsettled state law.

> *Thompson* v. *Magnolia Company*, 309 U. S. 478;
> *Foust* v. *Munson S. S. Lines*; 299 U. S. 77.

The purpose of referring questions of state law to state courts for decision is so that the laws would not "by the

"accident of federal jurisdiction—been determined contrary to the law of the State, which in such matters is supreme." (*Thompson* v. *Magnolia Company*, *supra*, at page 484.)

We have not found, nor has counsel for the petitioner pointed out any case where the bankruptcy court has relegated to a state court for decision a question involving the interpretation and effect of the Bankruptcy Act. By the very nature of things, the bankruptcy court has the final say on the bankruptcy law, and if it were the intention of the parties to agree that the question of whether the priority rights of the certificate holders were cognizable in the reorganization proceeding, not only would they have said so, but the Court would have, by a proper order, reserved the question for decision by the bankruptcy court.

If we are to consider the reservation as meaning that the question is to be determined in the light of the bankruptcy proceeding, we will arrive at the same result. Since no order in the proceeding nor the plan itself, modified the rights of the parties respecting priority or parity rights, the conclusion must be that those rights have not been affected by the plan.

In specification of errors, number 3, petitioner says that the question of parity is to be determined as a matter of Bankruptcy Law, because the Bornside certificate issue and Prudence were reorganized under Section 77-B. We deem it therefore, proper to point out that the Prudence plan made no effort to determine the question of parity. No such issue was raised in the Prudence proceeding. The Prudence plan however, did refer to the existence of an undetermined parity issue. In Article IV, section 2 of the Prudence plan, there is provision for the distribution of the assets of Prudence (R. 59) and in subdivision (a), (R. 60), it is provided that if uncertainty should exist whether certificates held by Prudence are on a parity with other certificates, the directors of the petitioner shall assume in the first instance that parity does not exist.

The rights to the money claimed in the second cause of action were preserved by the order confirming the Prudence plan in paragraph 20 (R. 82), as follows:

> "The Section 77-B Trustee of the Debtor is hereby further directed to transfer to the New Company forthwith, subject to all then existing equities and rights of third parties therein, all assets held by said Section 77-B Trustee for the account of others, or held by said Section 77-B Trustee in any agency or other segregated account pending settlement or determination of equities or rights asserted by others."

We thus see that the Prudence plan as well as the order confirming it did not determine the issue of parity and did not and made no effort to modify the rights of the parties. The Third specification of error can have no validity unless the mere reorganization of Prudence and the Burnside issue under Section 77-B with nothing more in and of itself, worked a change in the rights of the parties. That of course, is not the law. We submit that reorganizations under Section 77-B of the Bankruptcy Act work no automatic changes in the rights of creditors or stockholders, that such rights are affected only if and to the extent they are modified and altered by a confirmed plan. Otherwise, the elaborate plans with their multifarious provisions confirmed in the Burnside and Prudence proceedings were futile and unnecessary.

POINT IV.

THE RULE IN PRUDENCE REALIZATION CORP. v. GEIST, 316 U. S. 89, DOES NOT APPLY TO THIS CASE.

By an elaborate comparison of a portion of the reservation contained in this case with that contained in the *Geist* case, petitioner is attempting to make it appear that the precise question involved in this case has been passed upon and determined by this court in the *Geist* case. This claim however, is entirely without substance. In the case at bar, the reservation was contained in a provision of the plan, having consents of the requisite number of certificate holders and confirmed by the Court. The provisions of the plan have been fully stated and need not be repeated here. The Court and the parties treated the question as one to be determined out-

side of the bankruptcy court. Both the *Burnside* case and the *Amalgamated* case were closed, completely and irrevocably, without the issue being presented for decision by the bankruptcy court, nor did the bankruptcy court reserve the question unto itself for future determination. Unless we are to treat lightly this deliberate conduct on the part of all parties, their practical construction of the meaning of these provisions cannot be disregarded. In the *Geist* case, the plan itself provided for parity and that provision of the plan was not amended in the order of confirmation. There, the order of confirmation reserved the question of parity and before the termination of the bankruptcy proceedings, an application was made to the bankruptcy court for a determination. The order closing the bankruptcy proceeding reserved the question for decision in the bankruptcy court (R. 129). There is no question but that while bankruptcy proceedings are still pending, full control over the plan and its execution still resides in the bankruptcy court. The plan itself did in fact provide for parity and there the Court reserved the question as to whether the plan should accord parity. That is actually the way this Court treated the question when it came here. In the very first sentence of the opinion in the *Geist* case, this Court said at page 90:

> "The question for our decision is whether an insolvent defaulting guarantor of certificates of participation in a mortgage, who is also the owner of a part of the mortgage indebtedness, is entitled to share pro rata in a distribation of the proceeds of the mortgage in a § 77-B bankruptcy reorganization."

The opinion mentions the requirements of the Bankruptcy Act, that a plan of reorganization must be one which "is fair and equitable and does not discriminate unfairly in the case of any class of creditors" and that "dividends of an equal percent" shall be made "in all allowed claims except such as have priority or are secured". It talks about "the claims of Prudence" and of the impropriety of the "denial of the right to prove its claim".

What this Court decided there is succinctly and accurately stated in the headnote of the official report. It is in substance, that an insolvent defaulting guarantor of mortgage participation certificates is entitled to share pro rata in the distribution of the proceeds of the mortgage in a 77 B reorganization proceeding; that the New York rule that the guarantor impliedly agreed to subordinate his own claim, is taken as a rule of state law governing state liquidation and is not applicable to bankruptcy proceedings; and lastly, that the Bankruptcy Act prescribes its own criteria for distribution to creditors.

This Court was not called upon nor did it pass upon the meaning of the language of the reservation in the *Geist* case. No such issue was presented.

To read into the plan of reorganization confirmed for the Burnside issue, the rule of this Court in the *Geist* case, is to do violence to the provisions of the Burnside plan. It cannot be done except by a modification of the plan adopted.

We do not claim as intimated by petitioner, that the rule in this case must be different because it was brought in a state court. The forum in which an action is brought does not control the law applicable. We say that the result in this case would have to be the same whether the action were brought in a state court or federal court, because the New York law is the controlling law. We say that the bankruptcy court might have altered the rights of certificate holders so as to deprive them of their priority under state law, but that neither in the proceeding nor in the plan were such rights altered.

We do not discuss the basis of the New York Court of Appeals' statement of the New York law. We do not do so because as we understand the rule, this Court is not concerned with state law, but we think it proper to point out that the decision in this case as to the state law is consonant with its previous rulings. Petitioner concedes this, for he refers to the Court of Appeals' "persistent policy of subordination". The decision in this case is not inconsistent with that in the *Geist* case and we see no point in discussing the other points raised by the petitioner.

POINT V.

THE BURNSIDE PLAN CANNOT BE MODIFIED OR AMENDED IN THIS ACTION. THE PLAN IS NOT SUBJECT TO COLLATERAL ATTACK.

Petitioner's argument amounts to this: that under the doctrine enunciated by this Court in *Prudence* v. *Geist*, a plan is not fair and equitable which does not accord Prudence parity and hence we must read into the confirmed Burnside plan a provision according Prudence parity, notwithstanding that the plan contains no such provision.

If the plan of reorganization or any order in the bankruptcy proceeding altered or modified the rights of the parties on the question of parity, it would be binding upon all courts, state and federal alike. It would be just as binding as the provisions extending the mortgage, reducing the rate of interest and curtailing the rights of certificate holders to take independent action, relegating them to rights as beneficiaries of an express trust.

Suppose the plan had by explicit language declared Prudence certificates to be subordinate, could the petitioner now be heard to say that the policy of the bankruptcy act had been violated? Can it say that the provision for interest distribution provided in the plan to follow subordination is an improper one? We submit that the plan as confirmed is binding upon all and that it is not open to collateral attack. Errors, if any, in the reorganization proceeding cannot be corrected in this action.

An order confirming a plan of reorganization is res adjudicata.

> *Chicot County Drainage District* v. *Baxter State Bank*, 308 U. S. 371.

The Chicot County case was a suit on a bond issued by the Chicot County Drainage District which had been reorganized under the Municipal Debt Readjustments Act of 1934. The Act under which the petitioner had been reorganized was

subsequently declared to be unconstitutional by this Court. Nevertheless, this Court held that the decree approving the plan was res adjudicata and that it could not be collaterally attacked. There, this court said at page 378:

> "The remaining question is simply whether respondents, having failed to raise the question in the proceeding to which they were parties and in which they could have raised it and had it finally determined, were privileged to remain quiet and raise it in a subsequent suit. Such a view is contrary to the well-settled principle that *res judicata* may be pleaded as a bar, not only as respects matters actually presented to sustain or defeat the right asserted in the earlier proceeding but also as respects any other available matter which might have been presented to that end."

If the rule were otherwise a plan of reorganization would no longer be a charter which defines the rights of creditors and stockholders. Its provisions could no longer be relied upon in order to determine the manner and extent to which rights of creditors and stockholders have been altered and modified. Such a course cannot be permitted without destroying the binding force of the doctrine of res adjudicata and without endless litigation following in the wake of every reorganization proceeding.

May we be pardoned for one more illustration of the destructive force of petitioner's contention. In *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, this court reversed a decree confirming a corporate reorganization because of the improper retention of stockholders' rights, which this court held did not meet the standards that the plan must be fair and equitable. But suppose the decree confirming the plan had not been appealed from, would not the plan be as fully binding as if its provisions met the standards of the law? Under such circumstances, could creditors be heard to say that the stockholders were not entitled to share under the plan because to do so makes the plan unfair and inequitable? We think the answer obviously is that a plan is not

open to any such collateral attack and an attack upon its provisions is available only in a direct review upon appeal.

We submit that in the case at bar, this court as well as the courts below were foreclosed from examining the provisions of the plan for the purposes of determining whether they are in fact fair and equitable within the meaning of the Bankruptcy Law. All parties are bound by those provisions. Under them, the rights of priority of certificate holders over Prudence have not been modified or altered.

There is no attempted subversion of the policy of the Bankruptcy Law such as existed in *Local Loan Co. v. Hunt*, 292 U. S. 234. There, the State law attempted to nullify the effect of a discharge in bankruptcy by declaring that an assignment of future wages created a lien which survived the discharge in bankruptcy. Since the purpose and policy of the bankruptcy law was to permit a debtor to start afresh free from obligations consequent upon business misfortune, an attempt to reach his future earning under the guise of a lien was held to be destructive of the purposes and policy of the act.

Nor is there present here any attempt to narrow the protection secured by a federal act such as existed in *American Railway Express Company v. Levee*, 263 U. S. 19.

The Court of Appeals recognized the right of the Bankruptcy Court to modify and alter the rights of creditors. It gave full effect to the provisions of the Bankruptcy Act and the provisions of the plan of reorganization. The finding by the Court of Appeals that the plan did not alter or modify the rights of the parties with respect to the question of parity is amply supported by the record.

POINT VI.

THE JUDGMENT IS RIGHT AND SHOULD BE AFFIRMED.

Respectfully submitted,

CHARLES H. KRIGER,
Counsel for Respondents
Joseph W. Ferris, etc.

HENRIETTA KRIGER,
Of Counsel.